

Reform One Year After – Promises and Achievements

It has been a year since the Democratic Opposition of Serbia (DOS) came to power. At issue is quite certainly a very complex and long-lasting improvement of the economic conditions we live in and of the country's legal and political frameworks that are to guarantee stability and the rule of law. Nowhere like on the territory of Yugoslavia are daily politics, legal (non)predictability and (non)transparency so intricately intertwined with the economic indicators of development, factors of international financial support and the inflow of foreign direct investments. In view of this, the answer to the question – where are we now – is all the more complicated. It is, therefore, best to begin with a chronological order, i.e. with what has been promised, and how much of it has been achieved. One thing is certain: political stability and the rule of law in the country are necessary for the success of economic reforms. At the same time, the world is faced with deteriorating economic relations and the threat of long-term instability in the international capital market. Therefore, the credibility of our country depends primarily on the extent to which its own stability contributes to regional stability, and on the degree of resolve to continue along the path of reforms.

Day one

The promises from the Program for a Democratic Serbia, referring to the first day of the rule of DOS, have been partially fulfilled. In the first stage of rule, the reforms included the immediate lifting of the blockade against Montenegro, the non-discriminatory application of laws, the decision to open secret police files within 100 days, the abolition of detrimental laws, the abolition of the exit tax and independent budget auditing.

In a later stage of the initial period of rule, a Declaration was adopted on the new Constitution and the Proposal to the UN Security Council for the implementation of Resolution 1244 in Kosovo, in line with the reform program. The promises concerning the reporting of the material status of ministers and members of parliament, as well as the abolition of detrimental laws and the auditing of the budget, have been partially fulfilled.

In the implementation of the Program, the results related to the following issues have been negative:

- launching talks on the redefinition of the state (which remains an open question to this day);

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Analysis

Unemployment Compensation in Serbia

Macroeconomic Review

FRY Basic Economic Indicators	2000	2000 1999	VIII 2001	VIII 2001 VII 2001	VIII 2001 VIII 2000	I-VIII 2001 I-VIII 2000
GDP growth, in real 1994 prices ^a	...	8.4%	...	...	...	...
Industrial Production	...	10.9%	...	4.1%	-7.9%	-3.5%
Montenegro	...	3.7%	...	5.0%	-0.3%	-0.4%
Serbia	...	11.4%	...	4.0%	-8.4%	-3.7%
Central Serbia	...	12.0%	...	-3.0%	-14.7%	-7.6%
Vojvodina	...	10.1%	...	19.8%	6.1%	5.3%
Average nominal net wage - Serbia in Din. ¹	2,389	89.5%	6,091	12.2%	152.5%	137.7%
Real net wage - Serbia ¹	...	5.5%	...	9.1%	18.0%	7.1%
Average net wage - Serbia, in DEM ¹	93	-11.2%	200	12.2%	121.1%	108.1%
Average net wage - Serbia, in DEM ²	...	...	223	8.3%	...	...
Average gross wage - Serbia, in DEM ²	...	...	321	8.4%	...	...
Unemployment Rate - registered ³	28.38%	...	29.7%	-1.1%	3.6%	4.6%
Montenegro	...	...	39.4%	...	...	...
Serbia	27.45%	...	29.0%	...	...	...
Current account, in USD millions	-1,298	3.2%	...	...	...	...
Trade balance, in USD millions	-1,989	-10.6%	-140	1.4%	-0.7%	35.2%
Export - USD million	1,713	15.0%	130	-4.4%	-10.8%	2.1%
Montenegro	157	31.1%	9	200.0%	0.7%	-0.5%
Serbia	1,411	13.8%	121	-9.0%	-11.4%	2.5%
Import - USD million	3,662	12.6%	270	-1.5%	-6.5%	20.4%
Montenegro	313	-1.0%	27	800.0%	0.3%	32.5%
Serbia	3,035	15.6%	240	-10.1%	-7.6%	18.5%
Monetary supply (M1), end of period, in DIN billion	29.6	60.7%	48,547.30	7.11%	106.10%	100.66%
Cash	10.3	39.8%	16,118.80	6.61%	95.76%	88.67%
Deposits	19.3	74.9%	32,428.50	7.35%	111.66%	107.91%
Real money supply, end of period, in DM million	1,043	-26.7%	1,592.76	6.87%	96.39%	75.95%
Hard currency reserves, in million USD (end of period)	524	76.2%	950.40	5.4%	...	...
Discount rate	...	...	1.60%	-15.79%	-20.00%	-22.50%
Market interest rate, monthly level	5.84%	37.3%	4.96%	0.00%	-31.45%	-5.01%
Retail prices - Serbia	...	70.0%	...	2.7%	115.6%	118.1%
Consumer prices - Serbia	...	79.6%	...	2.9%	114.0%	121.9%
Producer prices - Serbia	...	102.6%	...	1.0%	97.1%	114.7%
Average exchange rate - Din./DEM	25.45	103.2%	30.48	0.2%	14.2%	7.0%

^a Figures refer to FRY without Kosovo

¹ Comparable to the average net wage calculated according to the method applied until June 1, 2001.

² By the gross wage calculation methodology applied as of June 1, 2001.

³ Figures refer to July 2001.

Most progress is in economic reforms

...and in the quick return to international institutions

However, political and institutional reform lags

- launching public administration reform (the reduction of the number of ministries by one third and the adoption of a law banning the accumulation of functions);
- resolution of the issue of missing and kidnapped persons in Kosovo; and
- publication of secret foreign policy documents.

In sum, these positive steps and delayed responses have made the fulfillment of promises for the first day only a half-success.

100 days

In the first one hundred days, the government sought to put ten laws up for debate in the assembly. It is no coincidence that the first on the list of promises was a package of economic reforms. It is this group of laws that the Program of DOS devotes the greatest attention to.

In the first 100 days of DOS's rule, a systemic reform of the monetary and fiscal systems was launched. A package of 11 fiscal laws was adopted in March and April. A new privatization law was drafted and the foreign trade regime was liberalized. The Program had planned the amending of the existing Law on Privatization, but it was abolished, and its implementation frozen in the mentioned period until the adoption of a new law. This was to halt the last minute accumulation of wealth by the former regime's nomenclature.

However, no progress was made in regard to the following issues:

- an anti-corruption law (although the first steps in the implementation of an anti-corruption campaign have been made);
- the old Public Information Act was abolished, but the freedom of the press has not been fully defined;
- adoption of a law on the army and police;
- regarding judicial reform: a law on courts and judges; a law on the public prosecutor's office, a law on the criminal procedure and the penal code;
- as part of the democratic reform: a law on the University; a law on local self-government and a law on elections.

In the second stage of the Program's implementation, after 100 days of rule, few of the given promises were actually fulfilled. Did this mean the slowing down of the democratic and economic reforms? Even though the above mentioned could lead to such a conclusion, the actual reasons lie in the very concept of the reform. There appeared an evident discrepancy between the creation of conditions for positive economic steps and the introduction of systemic economic law, on the one hand, and the legal-systemic and institutional reforms on the other. In this stage, the reform of the judiciary has still not moved from the beginning. DOS's official orientation in favor of protecting legalism has contributed to the establishment of the necessary legal and political stability in the country, on the one hand, but it placed obstacles to radical legal reforms (civil oversight of the army, the regulation of the role and field of activities of the police, checking of corruption, a reform of the court system and so on), on the other.

Year one

The reform Program promised the return of Yugoslavia and Serbia to the world. Inclusion into international financial and political institutions is proceeding at a very fast pace; all the sanctions have been lifted; and the Agreement on the equal succession of all the former Yugoslav republics has been signed. The prospects for Yugoslavia's inclusion in European processes of integration improved after the launching of talks with the European Union.

The mechanisms of the EU Stability Pact for South Eastern Europe are largely being applied to Yugoslavia, and it also recently joined the Pact's anti-corruption initiative. The inflow of international economic assistance has been facilitated by the success of the donors' conference in Brussels. Projects worth over 160 million dollars for the country's reconstruction and economic recovery were adopted by the end of June, and the value of the launched projects was 230 million dollars. A huge portion of these funds was directed towards energy. Social welfare and health care are the next priorities. This relatively favorable picture would be further enhanced by an information system that would inform the public and donors about the purposes the funds were used for. In its absence, the waning of public support for economic reforms is noticeable.

The fiscal reform that ensued encountered difficulties at the outset. A contributing factor was the strong resistance from the former regime's interest groups against the application of the Law on extra profit. Despite this, the fiscal system in Serbia is starting to resemble those in successful transition economies.

The budget reform is commendable, and especially impressive is the achieved firm stability of the domestic currency. In the inherited budget, there were large hidden deficits, which, in the year 2000, accounted for as much as 13% of the gross domestic product, while the new state budget is practically balanced, although part of the deficit will have to be covered through credits.

The correction of the disparity of prices for utilities and food (in line with the obligations undertaken in the arrangement with the IMF) has dealt a blow to the standard of living, particularly given the insufficient inflow of foreign credits. It is understandable that investors are cautious towards a country with 12.5 billion dollars worth of foreign debts. However, the stable domestic currency and the dramatic growth of the hard currency reserves (from the encountered US\$ 385 million to the present US\$ 1.044 billion), together with the dinar's internal convertibility, practically returned the economy to channels of so-called normal functioning. The domestic money supply has almost doubled, growing faster than retail prices, while the monetary system has been restructured and is subjected to supervision and the application of taxes.

The restoration of confidence in the banking system is making possible the payout of the so-called "old" blocked hard currency savings and the opening of several banks with foreign ownership, but this is quite certainly a long-term process. The positive effects are, undoubtedly, what now seem to be good prospects for the rescheduling of the foreign debt in the upcoming talks with the Paris and London Clubs of creditors. Whether our request for the "Naples conditions" implying the writing off 65% of the debt will truly be granted or not depends, of course, also on the general (unstable) climate on the world capital market and the creditors' assessment.

On the other hand, a year later, there are of course numerous unfinished reforms. Or more precisely, the harmonization of laws with European standards has been carried forward only in part, but this is a long-term task. Large investments to infrastructure have only begun. The privatization process has acquired a new legal framework, but favorable economic effects are yet to be expected. An especially sensitive and unresolved issue is the new agrarian policy, since it is not easy to rectify the effects of the exploitation of the village. In this regard, the citizens' social security has been drastically shaken, and the government, pressed by the necessity to have a balanced budget, does not have much maneuvering space for a comprehensive social policy.

Lying ahead is the large task of reforming the banking sector and resolving the issue of the insolvency of banks. The burden of the enormous foreign debt is one of the major problems our economy is faced with. It is on its resolution that both the dynamics and scope of the arrival of foreign investments, and thus also our economy's long-term growth and development, depend. This issue is soon to be resolved with the Paris and London Clubs, after which similar arrangements would ensue with other bilateral creditors as well.

For the sake of the continuation of the reforms, one must not forget that disputes and division within DOS could have a fatal effect on their further course and outcome. The experiences of other countries in transition clearly show that the *conditio sine qua non* of the success of reforms is: a political and social consensus on the concept and dynamics of reforms.

One Year After the Democratic Changes

Promises	Achievements		Score
	On time	Later	
FIRST DAY			
Declaration on new Constitution	no	yes	0.50
Non-discriminatory application of laws	yes		1.00
Lifting of the blockade against Montenegro	yes		1.00
Launching of talks on redefinition of the state	no		0.00
Proposal to Security Council for measures to implement Resolution 1244		yes	0.50
Reduction of number of ministries by 1/3	no		0.00
Law banning accumulation of functions	no		0.00
Decision to open secret police files within 100 days	yes		1.00
Resolution on reporting the material status of ministers and MPs (in practice)	no	partially	0.25
Resolution of the issue of kidnapped persons	no		0.00
Abolition of detrimental laws	yes	partially	0.75
Abolition of exit tax	yes		1.00
Independent budget auditing	yes	partially	0.50
Publication of secret documents on foreign policy	no		0.00
			0.46
FIRST 100 DAYS			
Package of economic reform laws (money, budget, privatization, social security, foreign trade protection)	yes		1.00
Anti-corruption law (in practice)	no	partially	0.25
Law on army and police	no		0.00
Law on courts and judges	no		0.00
Law on public prosecutor's office	no		0.00
Penal code and law on criminal procedure	no		0.00
Law on the media (in practice)	no	partially	0.25
Law on the University	no		0.00
Law on local self-government	no		0.00
Law on elections	no		0.00
			0.15
FIRST YEAR			
Inclusion in international political organizations	yes		0.95
Inclusion in international financial organizations	yes		1.00
Stability Pact and donors' conference	yes		1.00
Resolution of the issue of succession	yes		1.00
Launching talks on EU membership	yes		1.00
Harmonization of laws with European standards	partially		0.50
Balancing the state budget	partially		0.75
Launching fiscal reforms	yes		0.75
Stable money	yes		1.00
Restoration of confidence in banks	partially		0.50
Foreign financial support	partially		0.75
Liberalization of prices	yes		1.00
Debt rescheduling	partially		0.50
Foreign trade liberalization	yes		1.00
Privatization	partially		0.25
New agrarian policy	partially		0.25
Citizens' social security	partially		0.50
Initiate major investments in infrastructure	partially		0.25
			0.72

The Table shows an assessment of the degree of fulfillment of given promises in all three stages of the Program. The assessments are made according to a scale of 1 (full realization) to zero (total lack of realization).

- The promises referring to the first day of rule have a score of 0.46, which means that they have been partially fulfilled.
- The promises made in the first one hundred days of rule have a score of 0.15 and illustrate our stand that very little was achieved in that stage.
- The promises linked to the first year of rule have a score of 0.72, which actually confirms that practically all the promises made in this period were fulfilled.

Why such differences in the assessments and why the somewhat unusual dynamics of the Program's realization? At issue is not the order of the reform stages, but rather the nature of the reforms. The Table shows that, regarding changes of the legal system, DOS's promises have mostly remained unfulfilled. It is obvious that the policy of "legalism" has had double effects. It has contributed to the establishment of legal and political stability, but it has been an obstacle to radical legal reforms. On the other hand, the promises concerning the economic reform have been fulfilled to an enviable degree in all its stages.

Table and commentary: Mirosljub Labus

Labus makes his assessment

Unemployment Compensation in Serbia

Unemployment compensation is a basic right

Only 6% of the unemployed receive pecuniary compensation

A new Law on Employment came into force on June 1

Introduction

The experiences of countries in transition show that privatization almost inevitably leads to the quick rise of unemployment. Responsible state agencies endeavor to assist these persons in finding new jobs, mostly through active employment programs. However, in conditions of general restructuring, the likelihood of finding employment immediately is not great. Previously employed persons who lost their jobs as redundant labor, due to bankruptcy or for some other reason, as a rule have the right to pecuniary unemployment compensation.

A typical result of such a situation, which Serbia can easily find itself faced with, and which it is partly already experiencing, is a crisis in the funding of unemployment compensation. Even if unemployment does not grow considerably, or does not grow at all, the number of persons with the right to pecuniary compensation could significantly increase if the process of the restructuring of companies and banks intensifies. In this context, and in the light of comparative experiences, we will try to examine the impact of the recent change of the compensation regime and the reduction of the rate of payments for unemployment insurance on the realization of the rights of the persons who will be rendered jobless in the coming months.

Pecuniary compensation represents a very important, actually essential right in the system of mandatory unemployment insurance. The conditions for achieving this right, the encompassment, duration and amount of the compensation are regulated by the republican Law on Employment and the Realization of the Rights of Unemployed Persons.

According to figures of the Republican Bureau for the Labor Market, there were 778,000 unemployed persons in Serbia in August 2001, which represents a 6.5% increase compared to the same month last year. The unemployment rate in July 2001 was 29%. The number of unemployed persons in the first seven months of 2001 was approximately at the same level as in the same period last year.

In July 2001, the right to receive compensation on the basis of unemployment insurance was used by 53,487 persons, 30,780 of whom as redundant labor, 13,986 due to liquidations and bankruptcies and 8,721 on the basis of temporary employment or other circumstances. On average, the number of beneficiaries of unemployment compensation accounts for only around 6% of the total number of the unemployed. However, over the past three years, the number of compensation beneficiaries rose dramatically. The number of compensation beneficiaries in July 2001 was up 81% relative to the 1998 average.

Detailing the latest regulations

The right to pecuniary compensation belongs to unemployed persons who had mandatory unemployment insurance under provisions of the republican law for at least 9 months continuously or for periods with interruptions over the last 18 months of employment but totaling 12 months.

Pecuniary compensation belongs to unemployed persons whose employment was terminated:

1. due to the termination of the need for the employee's work, in line with the law;
2. due to bankruptcy or liquidation, i.e. in all other cases of the termination of the employer's work, in line with the law;
3. due to the non-achievement of the planned work results, i.e. the established inability to perform job requirements in line with the law, through no fault of the employee, and in if another workplace cannot be provided for him/her;
4. due to the transfer of the spouse, in line with special regulations;
5. due to the health condition of the unemployed person or members of his closest family;
6. if the person was employed abroad.

The right to pecuniary compensation also belongs to unemployed persons who were temporarily employed, except if his/her employment was terminated by his own will, or due to his own fault.

The right to pecuniary compensation belongs to employed persons who have achieved the right to employment on the basis of other grounds, and whose mandatory insurance was terminated through no will of his/her own or due to no fault of his/her own.

The right to pecuniary compensation belongs to disabled workers.

An unemployed person is obliged to register as such and to file a request within 42 days after the termination of his/her employment (the termination of insurance).

Pecuniary compensation is paid out to an unemployed person:

1. for 3 months, if he/she was insured for at least 9 months continuously or 12 months with interruptions over the last 18 months of employment;
2. for 6 months, if he/she was insured for 3 years continuously or 5 years with interruptions over the last 8 years of employment;
3. for 9 months, if he/she was insured for 10, but less than 15 years;
4. for 12 months, if he/she was insured for 15, but less than 20 years;
5. for 18 months, if he/she was insured for 20, but less than 25 years;
6. for 24 months, if he/she was insured for 25 years and more.

Prior to the amendments to the Law on Employment, which have been in force since June 1, persons who were insured for 30 years and more had the right to pecuniary compensation until

they found employment. That is, until the fulfillment of the conditions for an old-age pension in line with regulations on pension and disability insurance. On June 1, 2001, this right was abolished, so that persons who were insured for 25 years and more now have the right to compensation for a period of 24 months.

Compensation continues to be paid during pregnancy (which is recognized as maternity leave), temporary incapability to work as stipulated by regulations on health insurance and during preparation for employment, re-training, i.e. additional training of the unemployed.

The payment of compensation to an unemployed person is suspended while serving a prison sentence or during the implementation of security, educational or protective measures, for a 6-month period, and for the duration of military service.

An unemployed person's right to receive compensation is terminated if:

1. he/she finds employment or achieves the right to work based on other grounds;
2. opens a company or store, or engages in agriculture as one of or the only occupation;
3. fulfills the conditions for an old-age or disability pension,
4. starts serving a prison sentence;
5. turns down employment that suits his/her professional abilities;
6. turns down, for no justified reason, i.e. terminates initiated preparations for employment;
7. fails to report, for no justified reason, to the Employment Bureau or does not respond to its call.

Under the Law on Employment, which has been in force since June 1, 2001, the amount of the compensation is set at 60% of an unemployed person's average earnings, achieved in line with the Law, during the three months of employment. This sum is then enlarged by 2% for each year of service. Prior to the recent changes, the amount of the compensation was set at 70% of the unemployed person's average earnings, achieved in the month when his/her insurance was terminated, and enlarged by 2% for each year of insurance.

According to the amendments to the law, pecuniary compensation cannot be lower than 40% or higher than 80% of the average monthly wage per employed person in the economy of the Republic based on the latest published figures. These limits were broader prior to the changes and stood at 50% and 100% respectively.

Base compensation is set at 60% of the average wage in the last 3 months of employment

Table 1. Comparative Review of Unemployment Compensation Systems

Country	Rate of Contributions	Qualifying Conditions	Rate of Compensation	Duration of Compensation
Yugoslavia	Employee 0.55%; Employer 0.55%	9 months of continuous insurance or 12 months with interruptions over the last 18 months	60% of the average wage of the unemployed over the last 3 months preceding the month when employment was terminated; pecuniary compensation cannot be lower than 40% or higher than 80% of the average monthly wage in the last three months	Between 3 and 24 months
Slovenia	Employee 0.6%; Employer 0.6%	9 months of continuous insurance or 12 months with interruptions over the last 18 months	During the first 3 months of unemployment - 70% of the average wage of the unemployed person over the last 3 months; and 60% of the average for the remaining period	Between 3 and 12 months
Hungary	Employee - 1.5%	At least 1 year of insurance over the last 4 years	65% of the average wage during 4 calendar quarters prior to unemployment	Between 3 and 12 months
Slovakia	Employee 1% (self-employed 3%); Employer 3%	12 months of work experience over the preceding 3 years	60% of the average wage of the unemployed over the last 3 months during the first 3 months of unemployment, and 50% of the average for the remaining period	Between 3 and 12 months
Poland	Total 3.5% (allocated from the total contributions for pension and disability insurance)	Whether they were employed for 12 months over the preceding 18 months	75% of the previous wage	Between 3 and 12 months
Czech Republic	Employee 0.4%, Employer 3.2%; the state covers the deficit	6 months of contributions for insurance over the preceding 12 months	60% of the average wage of the unemployed over the last 3 months during the first 3 months of unemployment, and 50% of the average for the remaining period	6 months at the most
Germany	Employee - 3.25%, employer - 3.25%; the state covers the deficit	At least 12 months of insurance over the preceding 3 years	67% of the net wage	Between 6 and 23 months
Italy	Employer - 4.41% industry and 1.61% trade, employee - 0.30%; state subsidies	A year of insurance during the two years that preceded unemployment	30% of the previous wage	180 days
Belgium	Employer - 1.41% and employee - 0.87%, state subsidies	12 months of insurance during the last 18 to 24 months of the previous 36	60% of the wage	Without any time limit, but with a declining value to the compensation

95% of the Labor Bureau's revenue is from mandatory contributions

The rates of employer and employee contributions to unemployment insurance were also changed by the new law, which came into effect on June 1, 2001. The insured person – the employee – and the employer each pay their contribution at a rate of 0.55% on the gross wage. These rates were 0.9% prior to the change.

It is presumed that the reduction of the rate of payments to unemployment insurance was the result of the addition of certain earnings to the net wage. This shift also led to an increase in the gross wage to which the rate of contributions for social insurance is applied.

The current state of affairs

The average amount of unemployment compensation per beneficiary was 3,143 dinars in May 2001, which was up by 71% relative to the same month last year. The Republican Bureau for the Labor Market is three months behind in paying out pecuniary compensation. Funds from contributions for mandatory unemployment insurance comprise 95% of the Bureau's revenue.

In the 2001 plan of the Republican Bureau for the Labor Market, funds from contributions for unemployment insurance account for 43% of the total planned revenues, while the remaining 57% include funds from budget subsidies and from the Transition Fund.

In the first eight months of 2001, the highest share in the structure of achieved revenues is still that of revenues from contributions, while the share of funds from the republican budget is negligible (around 10% on the average), far below the plan. In the observed period, the collected revenues accounted for 36% of the total planned revenues for the year 2001, while funds from the republican budget have been arriving since May and they now account for only 7% of the plan.

Table 2: Revenues and expenditures of the Republican Institute of the Labor Market

DEM thousands

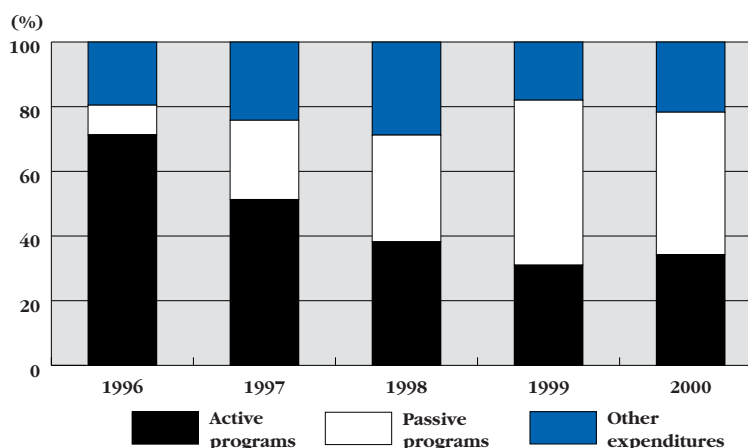
	1996	1997	1998	1999	2000
Funds from mandatory contributions	147,795	147,875	121,306	69,302	62,768
Other funds	9,543	6,621	5,776	2,920	3,656
TOTAL REVENUES	157,338	154,497	127,081	72,222	66,424
Active programs	112,229	78,260	49,056	23,880	23,173
Passive programs	14,365	37,355	42,288	39,297	29,769
Other expenditures	30,744	36,939	36,935	13,855	14,680
TOTAL EXPENDITURES	157,338	152,555	128,280	77,033	67,621

The structure of the expenditures of the Republican Bureau of the Labor Market, is comprised of: (1) funds allocated for active programs (support to investment programs, educational programs, stimulating the employment of the young, the introduction and development of an information system and so on); (2) passive programs (funds for pecuniary compensation, pension and disability insurance, health insurance); and (3) other expenditures (material costs, wages of the Bureau's employees).

In 2000, compared to the year 1996, the share of expenditures for active programs in total expenditures fell sharply (from 71.3% to 34.3%) and the share of expenditures for passive programs rose (from 9.1% to 44.0%), while the share of other expenditures was also considerably reduced. The tendency towards an increase in the share of expenditures for passive programs in the previous years was predominantly the result of both the reduction of the real scope of the Bureau's revenues, and of an only slow increase in the number of employees with the right to unemployment compensation.

The graph shows that the funds for unemployment compensation have increased at the expense of the funds for active programs. Experiences of countries in transition suggest that active programs are much more effective when the economy is on the rise and when the applied measures are directed towards workers with low qualifications and those unemployed on a long-term basis. In the observed period, Serbia had no systemic conditions for achieving the effectiveness of investments in active employment programs, so that the funds directed towards active programs did not produce positive change to the long-term unfavorable state of the labor market.

Structure of Expenditures of the Republican Institute for the Labor Market



Funds for pecuniary compensation have increased at the expense of funds for training and placement programs

In the future, the Republican Bureau should focus on active programs, providing necessary information on job vacancies and offering advice in the search for a job.

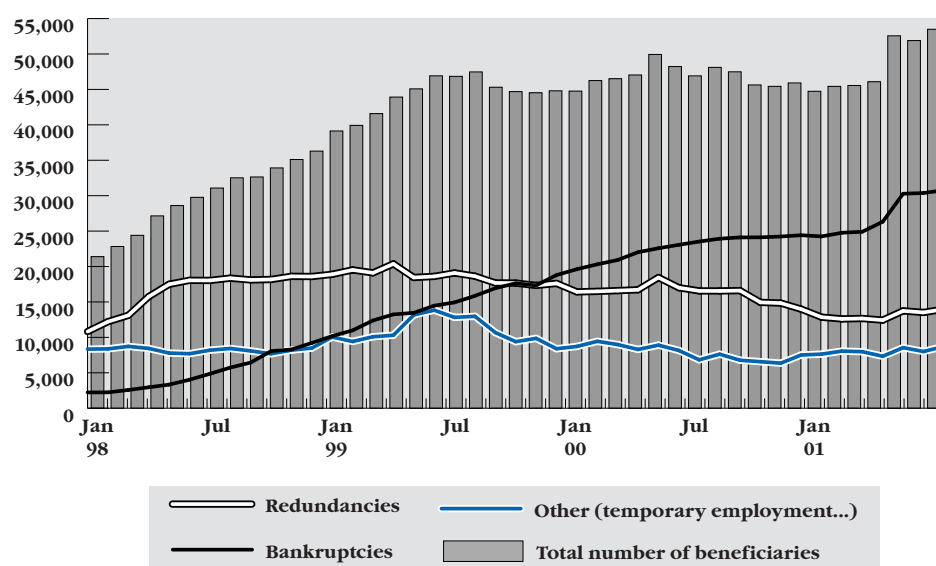
If we observe the share of the Republican Bureau for the Labor Market's activities in GDP for the period between 1996 and 2000, it ranges around 0.9% on the average and is at the same level as in Slovenia in the 1991-1995 period. The funds for pecuniary compensation in the 1996-2000 period increased their share from 0.04% in 1996 to 0.2% in 2000, which is still far lower than in Slovenia. With an increase in the number of beneficiaries of pecuniary compensation, the share of compensation in GDP is expected to grow.

Table 3. Republic Bureau of the Labor Market: Share of GDP in %

Yugoslavia	1996	1997	1998	1999	2000
unemployment compensation	0.04	0.08	0.14	0.18	0.20
total Bureau expenditures	1.09	0.92	0.92	0.76	0.84
Slovenia	1991	1992	1993	1994	1995
unemployment compensation	0.46	0.59	0.97	0.91	0.66
total Bureau expenditures	0.67	0.85	1.22	1.15	0.78

An increase in the number of compensation beneficiaries with a sharp rise in redundancies will negatively affect the Bureau's financial position. Observed since 1998, the number of beneficiaries following redundancy has had a linear upward trend that will quite certainly continue, and perhaps even accelerate at one point. The number of beneficiaries resulting from bankruptcy, liquidation, termination of temporary employment and so on was stable since 1998.

Number of Unemployed Beneficiaries in Serbia



Redundancy-related beneficiaries receive 30% higher compensation, on the average, than other beneficiaries do. The linear growth trend of the number of such high-cost beneficiaries is quite certainly one of the problems the Bureau will face when it comes to available funds for paying out unemployment compensation, which even now is notoriously late.

An analysis of unemployment compensation trends shows that our system is generous when compared to the wage trends in the Republic of Serbia. Such a situation produces incentives that may prolong unemployment. These negative incentives are not dampened by the relatively long duration of the right to unemployment compensation. The maximal period for receiving unemployment compensation should be reduced from 24 to 12 months, as it stands in other transition countries. As regards the amount of compensation in relation to the last wage, with the changes that came into effect on June 1, the alteration of the upper and lower limits from 50%-100% to 40%-80% of the average wage in the economy can be considered optimal. From the perspective of the

Table 4. Funds Paid per Beneficiary

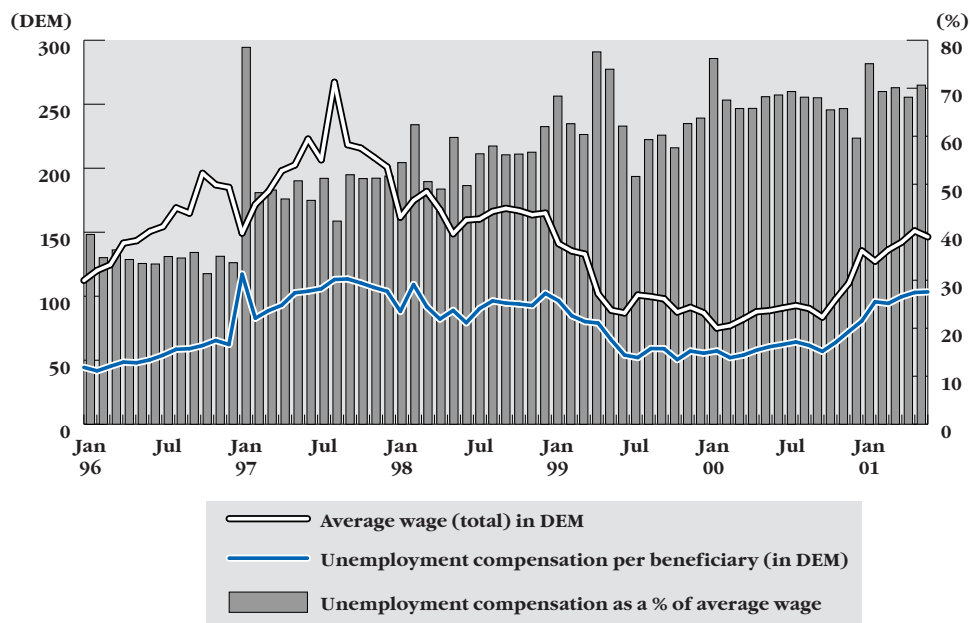
Funds Paid per Beneficiary		Funds Paid per Beneficiary (in DIN)		
		Redundancies	Bankruptcy	Other
Jan-01	2,860	3,324	2,162	2,561
Feb-01	2,846	3,274	2,162	2,597
Mar-01	3,006	3,468	2,235	2,785
Apr-01	3,121	3,475	2,541	2,830
May-01	3,143	3,540	2,557	2,678

Redundancies from industrial restructuring will strain the budget further

Long-term compensation with minimal retraining creates perverse incentives

protection of unemployed persons' standard of living, less would be insufficient for bare survival, while more would be fiscally unsustainable. The rate of replacement (the share of the compensation in the wage which the employed had prior to his/her unemployment) was reduced from 70% to 60%, which is also a step in the right direction.

Unemployment Compensation and Average Net Wage in Serbia



The Labor Bureau's budget gap is covered by the Transition Fund

Is the system sustainable?

The question that arises is whether the Republican Bureau for the Labor Market will be able to finance obligations stemming from unemployment compensation over the following months when a more intensive process of restructuring companies and banks is expected. If gross wages grow at a rate of 6% per month from September until the end of the year and the overall number of the unemployed remains at the existing level, the Bureau will achieve somewhat higher revenues than planned based on contributions for unemployment insurance. The share of the Bureau's operating costs (material costs, wages of the employed, and so on) in total revenues is around 15% per month on the average.

If the share of these costs will not change until the end of the year, the Bureau will be left with a sum of money with which it will be able to provide funds for around 56,000 beneficiaries per month on average. This presupposes growth of around 1,000 persons per month to the number of beneficiaries. However, the Bureau already has obligations regarding active programs, which demand additional funds for their realization.

Such a situation indicates that the crisis in the payment of unemployment compensation would have deepened if the government had not formed the so-called transition fund through which it is ensuring funds for the social program linked to the restructuring of companies. The money in this fund is provided from donations and the republican budget.

It is therefore possible to conclude the following:

- (1) The adopted measures concerning the labor market policy will lead to: (a) reduced costs of labor which means the unburdening of the economy, and (b) reduced social costs in the process of restructuring companies and banks;
- (2) With the same scope of employment and the present rate of contributions for unemployment insurance, the existing gross wage fund cannot provide sufficient funds for the already assumed obligations concerning the active programs of the Bureau for the Labor Market and the realization of the rights of the unemployed who have been rendered jobless or will be left without a job by the end of the year;
- (3) The government is acting to overcome the difficulties in the fulfillment of obligations from the labor market policy with additional funds from the republican transition fund (donations, the budget, credits for structural adjustment). In other words, the government will directly subsidize the Bureau by way of the Transition Fund;
- (4) The government has taken upon itself to ensure the social security of the employees who will temporarily remain without jobs as process of corporate restructuring gathers pace. The model of restructuring for Zastava of Kragujevac and the resolution of the issue of redundant labor in this company proved to be effective. The government is expected to apply this model in the restructuring of other similar companies as well.

MACROECONOMIC REVIEW

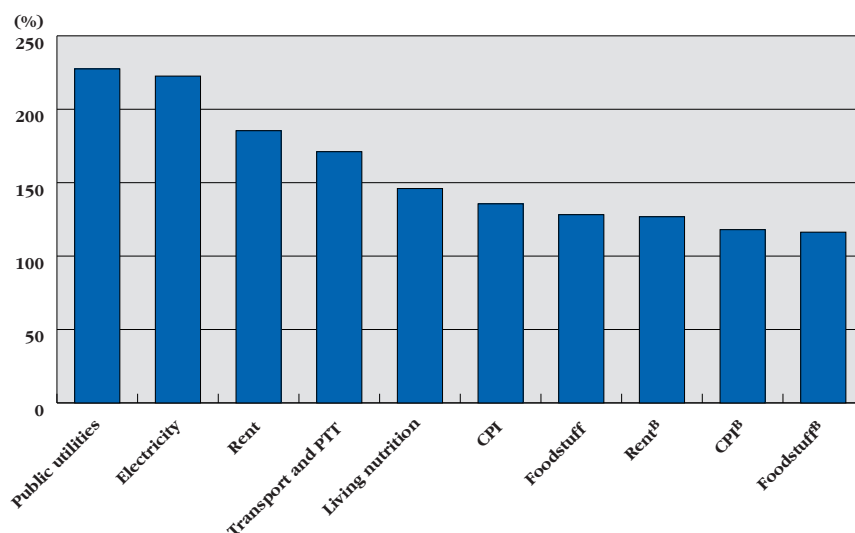
Prices

Retail prices in Serbia are up 2.7% in August. Price adjustments to telephone services and partly to transport services in this month as well and price of services were up 6.4%. On the other hand, the price of goods was up by only 1.6% in August. This growth was mostly influenced by the price corrections in meat and bread leading industrial food products to a growth rate of 5.5% for the month. Industrial producer prices were up 1% in August. *Year-on-year, retail prices were up 118.1%, while for the eight months of this calendar year they grew 31.1%.*

The cost-of-living index was up 2.9% in August. This was largely due to 4.2% growth in the price of basic nutrition and 18.6% growth in transport and postal service prices. For the items comprising the CPI, the prices of goods were up 2.4% in August and the prices of services grew by 7.5%. *Year-on-year, the cost of living was up 121.9%, while in the first eight months of this calendar year they grew 35.6%.*

Retail prices are up 2.7% in August

Rate of Price Growth (January-August 2001)



Therefore, total inflation, measured by costs of living, for the first eight months is 35.6%. This rate can be decomposed. Namely, *by a cumulative rate of price in the costs of living, a share of transferred inflation which includes the correction of the general level of prices in the three categories of living necessities (bread, milk and meat), electric power, public utilities, transport and postal services shows inflation at 23.6%. Prices measured by a basic inflation index were up 18% for the calendar year.*

Despite the announced 15% rise in price of electric power set for October 1, we project no further liberalization of prices for the remainder of the year. As such, the inflation rate per year measured by retail prices should not significantly exceed 40%. Since the upper limit of projected inflation for this year has been 35%, with 31.1% achieved by August and the average price growth rate in the last three months of 3%, the above mentioned expectations are reasonably sound.

Inflation is projected at just over 40% for the year

Monthly Indices of Price

	I	II	III	IV	V	VI	VII	VIII
CPI	103.2	101.5	102.3	111.3	103.5	104.7	101.8	102.9
Food, beverages, tobacco	100.8	100.1	103.0	110.0	104.4	101.6	101.4	104.2
Living Nutrition	99.4	100.9	106.6	117.3	102.0	103.0	101.7	109.0
Foodstuff ^B	101.7	99.6	100.5	105.2	106.1	100.6	101.2	101.0
Housing	113.9	102.6	102.7	127.6	101.2	119.1	100.5	99.9
Electricity	100.1	100.0	100.0	159.3	100.0	139.7	100.0	100.0
Utilities	189.3	108.4	101.9	102.1	103.4	100.6	100.4	102.0
Rent ^B	111.0	104.4	106.4	94.3	102.2	97.9	101.3	99.2
Transport and Telecommunication	103.5	104.5	100.0	109.4	100.3	102.5	118.5	118.6
CPI ^B	102.6	101.5	101.3	104.2	104.6	101.3	101.3	100.6

Note: Cost Price Index^B (CPI^B) represents a basic inflation indicator. It has been calculated on the basis of the CPI, from which bread, meat and milk, electric power, public utilities, transport and postal services have been deducted. In addition, 33.4%

Source: Republic Bureau of Statistics

Restrictive fiscal policy to a lesser extent and price parity change to a greater extent (owing to higher rise in the price of electric power and services compared to dynamics of price growth in goods) have shifted a part of demand for goods to demand for services. This can account for a slow development of finished goods inventories since February this year. Price parity changes, on the one side, reduced demand for goods and increased demand for services on the other side, as well as rising costs of production could lead to problems in price adjustment in the next period. Consequently, a further rise in prices could depend on whether the goods of a given sector are price elastic or not.

Wages

According to data of the Republic Bureau of Statistics, average gross wage in August in Serbia was 9,799 dinars or 321 DM according to the current foreign exchange rate. The average net wage in August was 6,091 dinars (200DM), applying the accounting method effective until 1 June, or 6,800 dinars (223 DM) according to the new accounting methodology. The average income (according to new accounting) expressed in DM has grown by somewhat more than 8% compared to the previous month. The difference between the average net income, expressed by the current and by the previous methodology, was 11.6% this month. In August the average net

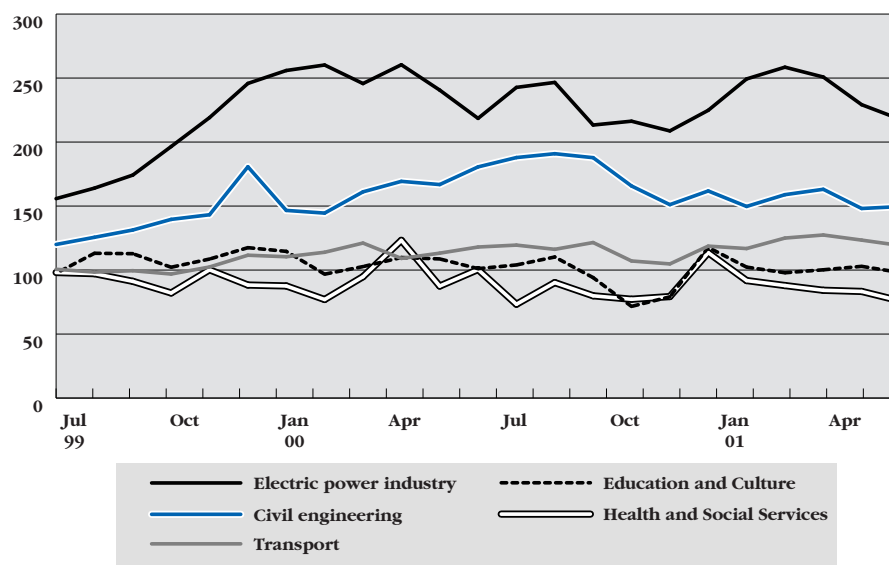
Real wages are up, but productivity gains lag

income (according to the previous method of accounting) displayed a nominal increase of 12.2%. The real purchasing power of income expressed in cost of living units was up this month by 9.1% month-on-month. The average wage calculated in August this year showed a real increase of 18% year-on-year, while the average for the first eight months of 2001 was up by 7.1% in relation to the same period last year.

Income in the FRY grew nominally by 4.9% compared to July. Of the total 60.5 billion dinars paid 20.9 billion dinars or 11.5% more compared to the previous month was paid in gross income to the employed, while the total amount of mandatory pension contributions (7.5 billion dinars) was up 7.8% compared to the July total. At the same time, the total sum of 30.6 billion dinars was collected from the population or 2.5% more compared to July. 25.3 billion dinars of that sum was received in terms of realized goods and services while tax and contribution collections were down by 0.1%, totaling 4.2 billion dinars.

In order to achieve success of the future reforms one of the necessary conditions is slowing down inflation in order to reduce the pressure on the state treasury. There is still an open issue how to maintain the income level within "really permitted limits" when it is evident that the income in some very important activities financed from the budget is far below the balanced level, while a real basis for production growth does not exist.

Index of Real Income by Sectors in Serbia
(average 1997=100)



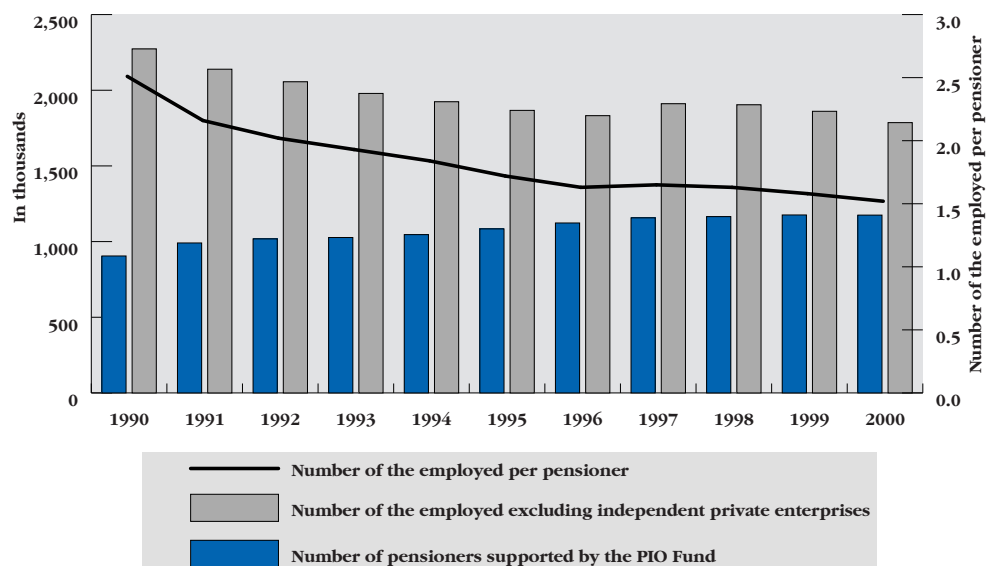
The ratio of employed to pensioners is only 1.52

The employed and pensioners

A fall in ratio of the number of the employed to pensioners from 2.51 in 1990 to only 1.52 in 2000, is a consequence of a long term downward trend in the number of the employed and a long term upward trend in the number of pensioners. It is necessary to emphasize that in the given period there were twice (1992 and 1996) amendments to the Law on Old-age Pension and Disability Insurance and that the highest period of increase in the number of pensioners was in the years preceding these changes. Thus in 1991 the increase in the number of pensioners was 9.6% compared to the previous year, while in 1996 it was 3.6%.

In the period 1991-1996 the average growth rate of the number of pensioners per year was 3.7% while a fall in a number of the employed averaged 3.5% annually. In the period 1997-2000 these growth rates were 1.13% to 0.63%. The unfavorable ratio of the number of pensioners to the number of the employed resulted in part from our citizens' inclination to early retirement (when they have about 30 years of service and when they are 55-60 years of age). Also, retirement has served as a valve for resolving the problem of redundancies under very hard economic conditions. Significant reform of the old-age pension and disability system of insurance reform is therefore necessary to establish old-age pension funds with capital cover (state, private, or mixed).

The Employed and Pensioners in Serbia without Kosovo and Metohija



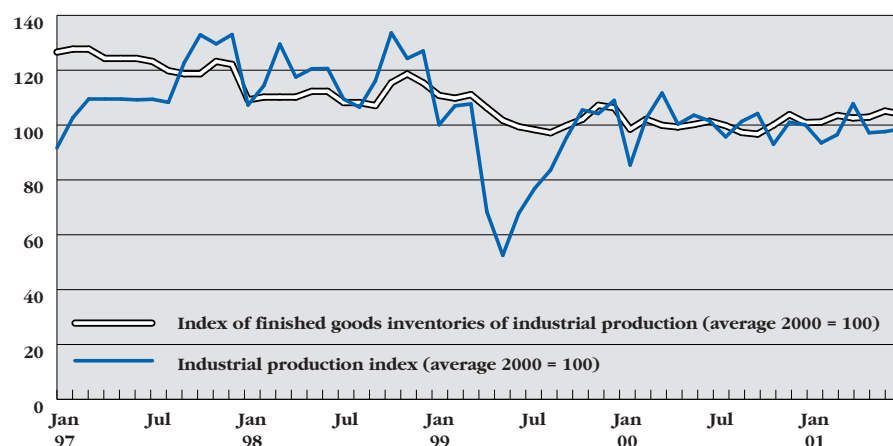
Industrial production

Industrial production in the FRY was up 4.1% in August, month-on-month. In Montenegro production was up 5.0% while in Serbia it rose by 4.0%. In Central Serbia production was down 3.0% while in Vojvodina it rose 19.8%. The de-seasonal index for August is shows a drop in production of 1.3%, month-on-month.

Industrial production in the FRY was down in August 2001 by 7.9% compared to the same month the previous year when the same seasonal factors were effective. In Montenegro production was down 0.3% while in Serbia it fell 8.4%. In Central Serbia production dropped 14.7% while in Vojvodina production was up 6.1%.

Industrial production in the FRY for the period January-August 2001 fell 3.5% compared to the same period last year. In Montenegro production was down 0.4%, while in Serbia it fell 3.7%. In Central Serbia production fell 7.6%, while in Vojvodina it increased 5.3%.

Indices of Finished Goods Inventories and Industrial Production in the FRY



Foreign trade

Preliminary data indicate that the value of trade between Serbia and foreign countries fell in August. Commodity exports in August were valued at US\$ 121 million, which is down 9% month-on-month, and down 11.4% compared to August of last year. This trend has resulted primarily from this year's reduction in exports from Central Serbia to the developing countries (down by more than 40% to about US\$ 30 million) and to the countries in transition (down 15% to almost US\$ 50 million). Total exports from Central Serbia fell by around US\$ 25 million compared to the first eight months of last year. Vojvodina, on the other hand, is achieving much better results. Its exports for the same period have increased by US\$ 50 million. August imports to Serbia were worth US\$ 240 million, down 10.1% month-on-month, and 7.6% less than August of last year. Exports and imports for the eight months of the calendar year are up compared to the same period in 2001 by 2.5% and 18.5%, respectively.

Data on the federal state are similar and growth rates have deviated since the beginning of the year by 2 percentage points at most compared to those referring to Serbia. Trade has fallen short of expectations from the beginning of the year (according to which the projected annual export growth rate was 15% and import growth rate 14.4%). Federal authorities are aware of this adverse trend in the balance of trade, but remain optimists and are of the opinion that exports will spike upward toward the end of the year, as a delayed reaction to foreign trade liberalization and a lifting of the outer wall of sanctions.

In commodity exports from Serbia, finished garments predominate (valued at US\$ 115 million, representing a 33% increase compared to the same period last year), vegetable and fruits (US\$ 83 million) and non-ferrous metals (US\$ 74 million). Exports of the most important produce of Serbia – raspberries – have totaled US\$ 39 million US dollars and are at almost the same level as in the first eight months of last year. The export value of some traditional export commodities fell. Medical and pharmaceutical products were down by one quarter. Exports of sour cherries dropped by 35%, and cut beech-tree fell by more than a half. However, exports of new automobile tires grew by 50% and cold rolled products of iron rose by more than 300%.

Since the beginning of the year imports were up in almost all sectors of the standard international trade classification compared to the same period last year. Petroleum and petroleum products still have the greatest share in imports, totaling US\$ 352 million. Registered cigarette imports rose considerably (which is explained by the reduced volume of black-marketeering of this product compared to previous years), fertilizers and raw materials for their production were up, as was transport equipment (almost four times higher in value than in the first eight months of last year). On the other hand, there has been a fall in cork and timber imports, road vehicles (by more than a third) and coal and coke (by three-quarters).

A regional analysis of foreign trade, as could be expected, focuses on two major regions – the European Union and the Central and Eastern Europe countries. Their share in exports and imports is very similar and together they account for more than 90% of this year's exports and more than 80% imports. A trend is positive in that the commodity exchange value is up compared to the first eight months last year (except for a slight drop in exports to the countries in transition, which has resulted from conflict in Macedonia). Among the developed countries, there is a significant rise in trade with Germany, Italy, and France, while among the countries in transition, except Russia, neighboring countries are favored. This is an encouraging trend since the expansion of trade with neighboring countries is essential – not only because of geographical advantages and historical connection with these markets but also because of the fact that successful regional cooperation is one of the prerequisites for becoming a member of the European Union. Naturally, *the trade level is far below the level that could be realized. It is in the interest of all countries in the region to strive for accelerated removal of obstacles to their mutual trade and the establishment a kind of regional economic integration.*

However, less encouraging is that in commodity trade with all the most important trading partners except for Macedonia and Bosnia and Herzegovina, Serbia is showing a deficit. The largest trade deficit is with Russia (US\$ 367 million since the beginning of the year, largely due to gas imports) and Germany (US\$ 201 million). Even in trade with Italy and Romania the deficit has almost reached the sum of US\$ 100 million.

Foreign exchange reserves of the National Bank of Yugoslavia are still rising. Their level in the second half of September of 980 million US dollars could cover 2.8 import months (if the average monthly import value since the beginning of the year is considered). Foreign exchange reserves are projected to reach US\$ 1 billion and probably more by the end of the year.

Industrial production is low and flat, awaiting a more positive environment for investment

Finished garment exports are up 33% to \$115 million

The exchange rate remains stable, and interest rates are beginning to fall

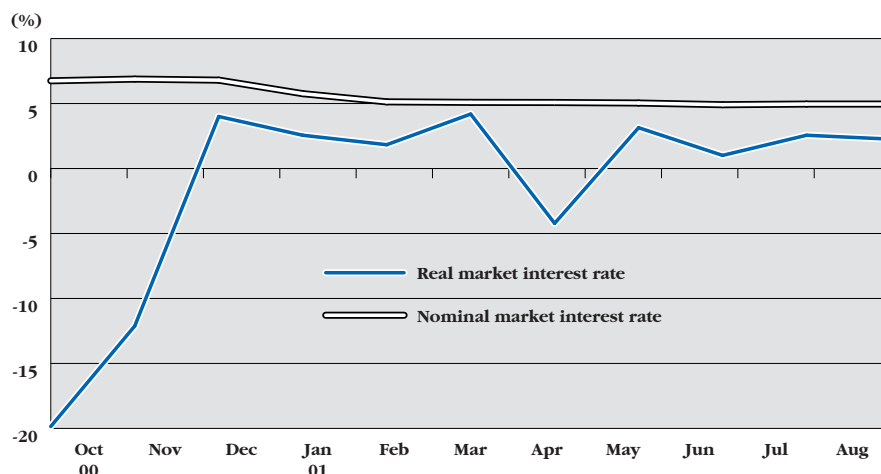
Hard currency reserves top \$1 billion and cover 128.6% of M1

Excise tax collection is up

Monetary and fiscal policy

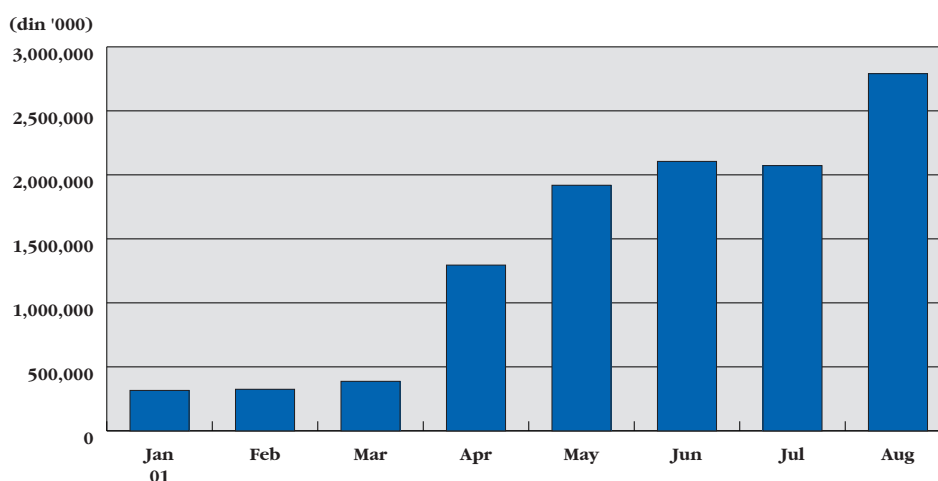
The Central bank of Yugoslavia decreased the discount rate to 1.6% a month on 25 August. The interest rate on the money market in August remained unchanged at the level of 4.9% a month. However, in September the interest rate began to fall to a level below 4.5% and representing a positive signal for the revival of economic activity. Since the stability of the national currency within the regime of a managed floating foreign exchange rate was maintained in August, dinar investments are still more attractive than foreign currency ones, which is one of the factors affecting the increased demand for dinars. The basic benchmark affecting the limit of the market interest rate on the Belgrade Stock Exchange is the foreign exchange rate, not the retail price growth rate. Since the foreign exchange rate has remained stable in 2001, nominal market interest rates have shown a mild downward trend. If the stability of the foreign exchange rate is maintained, a further reduction in nominal interest rates can be expected.

Nominal and Real Market Interest Rate



The money supply grew in August 7.1%, month-on-month. It is interesting to note that unlike in previous months, primary issue has not resulted exclusively from foreign exchange transactions. In August of this year, the National Bank of Yugoslavia provided credit financing for the first time credit to finance the budget deficit. In this way 1.15 billion dinars of primary money were issued. The amount of securities sold by the Central Bank of Yugoslavia has also increased by 1.15 billion dinars. Therefore, it seems that the funds needed for budget deficit financing were mostly collected on the money market through the Central Bank of Yugoslavia. On the basis of foreign exchange transactions an additional 1.7 billion dinars of primary money was issued. Coverage of M1 by foreign currency reserves totaled 128.6% at the end of August, which is less than the July level of 135.8%, but remains satisfactory.

Excise Duty Revenue



The trend of public revenue collection in August continues to improve. A total of 30.37 billion dinars was collected or 9.2% more than in July. The revenue of social insurance organizations increased to 10.4 billion dinars, up 10.2% month-on-month, while 19.92 billion dinars were collected for the general budget, up 8.7% month-on-month. Increased revenue from excise duties is especially important and indicates some success in combating contraband petroleum products and cigarettes. Excise duty revenue is up 34.7% month-on-month. In August excise duty revenue totaled 24.5% of public revenue in the Republic budget. Thus, for the first time this year, excise revenue achieved budget projections of 23.7%. *Achieving short-term budget revenue targets and the success of medium-term fiscal reform is in large part dependent on the success of excise duty revenue collection.*